

Letter of Findings: 04-20130645
Sales and Use Tax
For the Years 2010, 2011, and 2012

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ISSUE

I. Sales and Use Tax - Imposition.

Authority: IC § 6-2.5-1-2; IC § 6-2.5-2-1; IC § 6-2.5-3-1; IC § 6-2.5-3-2; IC § 6-2.5-4-1; IC § 6-2.5-5-3; IC § 6-2.5-5-5.1; IC § 6-8.1-5-1; [45 IAC 2.2-5-8](#); [45 IAC 2.2-5-12](#); Lafayette Square Amoco, Inc. v. Indiana Dep't of State Revenue, 867 N.E.2d 289 (Ind. Tax Ct. 2007); Indiana Dep't. of State Revenue v. Rent-A-Center East, Inc., 963 N.E.2d 463 (Ind. 2012); Scopelite v. Indiana Dep't of Local Gov't Fin., 939 N.E.2d 1138 (Ind. Tax Ct. 2010); Wendt LLP v. Indiana Dep't of State Revenue, 977 N.E.2d 480 (Ind. Tax Ct. 2012); Rhoads v. Indiana Dep't of State Revenue, 774 N.E.2d 1044 (Ind. Tax Ct. 2002); USAir, Inc. v. Indiana Dep't of State Revenue, 623 N.E.2d 466 (Ind. Tax Ct. 1993); Indiana Dep't. of State Revenue, Sales Tax Division v. RCA Corp., 310 N.E.2d 96 (Ind. Ct. App. 1974); Indiana Dep't of State Revenue v. Kimball Int'l Inc., 520 N.E.2d 454 (Ind. Ct. App. 1988); Tri-States Double Cola Bottling Co. v. Dep't of State Revenue, 706 N.E.2d 282 (Ind. Tax Ct. 1999); Mynsberge v. Indiana Dep't of State Revenue, 716 N.E.2d 629 (Ind. Tax Ct. 1999); Mumma Bros. Drilling Co. v. Indiana Dep't of State Revenue, 411 N.E.2d 676 (Ind. Ct. App. 1980); Indiana Dep't of State Revenue v. Cave Stone, Inc., 457 N.E.2d 520 (Ind. 1983).

Taxpayer protests the assessment of sales/use tax on purchases of tangible personal property.

STATEMENT OF FACTS

Taxpayer is a company doing business in Indiana. The Indiana Department of Revenue ("Department") conducted a sales and use tax audit for tax years 2010, 2011, and 2012. Pursuant to the audit, the Department determined that Taxpayer did not pay sales tax or self-assess use tax on certain purchases of tangible personal property used in the course of its business. That property consisted of a sand heater (also known as sand dryer), loaders, repair parts, tires, off-road diesel fuel, software subscriptions with upgrades, and magazine subscriptions. As a result, the Department's audit assessed additional use tax and interest. The Department, nonetheless, waived the negligence penalty.

Taxpayer only protests the assessment on its purchase of the sand dryer as well as repair parts and diesel fuel used in connection to the sand dryer ("Items at Issue"). A hearing was held. This Letter of Findings ensues. Additional facts will be provided as necessary.

I. Sales and Use Tax - Imposition.

DISCUSSION

The Department's audit found that Taxpayer is "a manufacturer of ready-mix concrete." Nonetheless, the audit assessed use tax on the Items at Issue because Taxpayer did not pay sales tax or self-assess use tax for its purchase of the Items at Issue. Specifically, the audit determined that Taxpayer's use of the Items at Issue does not qualify for any exemptions.

Taxpayer, to the contrary, claims that it was entitled to the manufacturing exemption on the purchases and use of the Items at Issue. Taxpayer states, in relevant part, that:

The requirements for the production of ready mix concrete state the materials must not be in a frozen state and must achieve proper temperature and moisture content at time of mixing. Adhering to these material requirements has a direct and immediate effect on meeting concrete specifications; if the concrete is not at the temperature specified and in the proper physical state, the concrete will not set up properly and the production process will fail. Therefore, the materials consumed as well as the processes needed to bring the

materials to the proper temperature and consistency during production should be exempt from sales tax according to [45 IAC 2.2-5-12](#).

Accordingly, the issue in this case is, as a manufacturer of ready-mix concrete, whether Taxpayer's use of the Items at Issue qualifies for the manufacturing exemption.

As a threshold issue, all tax assessments are prima facie evidence that the Department's claim for the unpaid tax is valid; the taxpayer bears the burden of proving that any assessment is incorrect. IC § 6-8.1-5-1(c); *Lafayette Square Amoco, Inc. v. Indiana Dep't of State Revenue*, 867 N.E.2d 289, 292 (Ind. Tax Ct. 2007); *Indiana Dep't of State Revenue v. Rent-A-Center East, Inc.*, 963 N.E.2d 463, 466 (Ind. 2012). Thus, the taxpayer is required to provide documentation explaining and supporting its challenge that the Department's assessment is wrong. Poorly developed and non-cogent arguments are subject to waiver. *Scopelite v. Indiana Dep't of Local Gov't Fin.*, 939 N.E.2d 1138, 1145 (Ind. Tax Ct. 2010); *Wendt LLP v. Indiana Dep't of State Revenue*, 977 N.E.2d 480, 486 n.9 (Ind. Tax Ct. 2012).

Indiana imposes an excise tax called "the state gross retail tax" (or "sales tax") on retail transactions made in Indiana. IC § 6-2.5-2-1(a). A person who acquires property in a retail transaction (a "retail purchaser") is liable for the sales tax on the transaction. IC § 6-2.5-2-1(b). Indiana also imposes a complementary excise tax called "the use tax" on "the storage, use, or consumption of tangible personal property in Indiana if the property was acquired in a retail transaction, regardless of the location of that transaction or of the retail merchant making that transaction." IC § 6-2.5-3-2(a). "Use" means the "exercise of any right or power of ownership over tangible personal property." IC § 6-2.5-3-1(a). The use tax is functionally equivalent to the sales tax. See *Rhoads v. Indiana Dep't of State Revenue*, 774 N.E.2d 1044, 1047 (Ind. Tax Ct. 2002).

By complementing the sales tax, the use tax ensures that non-exempt retail transactions (particularly out-of-state retail transactions) that escape sales tax liability are nevertheless taxed. *Rhoads*, 774 N.E.2d at 1048; *USAir, Inc. v. Indiana Dep't of State Revenue*, 623 N.E.2d 466, 468 - 69 (Ind. Tax Ct. 1993). The use tax ensures that, after such goods arrive in Indiana, the retail purchasers of the goods bear their fair share of the tax burden. *Rhoads*, 774 N.E.2d at 1050. To trigger imposition of Indiana's use tax, tangible personal property must (as a threshold matter) be acquired in a retail transaction. IC § 6-2.5-3-2(a); *USAir, Inc.*, 623 N.E.2d at 468 - 69. A taxable retail transaction occurs when (1) a party acquires tangible personal property as part of its ordinary business for the purpose of reselling the property; (2) that property is then exchanged between parties for consideration; and (3) the property is used in Indiana. See IC § 6-2.5-1-2; IC § 6-2.5-4-1(b) and (c); IC § 6-2.5-3-2(a).

Generally, all purchases of tangible personal property by persons engaged in the direct production, manufacture, fabrication, assembly, or finishing of tangible personal property are taxable, unless specifically exempt by a statute. [45 IAC 2.2-5-8](#)(a). A statute which provides a tax exemption, however, is strictly construed against the taxpayer. *Indiana Dep't. of State Revenue, Sales Tax Division v. RCA Corp.*, 310 N.E.2d 96, 97 (Ind. Ct. App. 1974). "[W]here such an exemption is claimed, the party claiming the same must show a case, by sufficient evidence, which is clearly within the exact letter of the law." *Id.* at 101 (quoting *Conklin v. Town of Cambridge City* (1877), 58 Ind. 130, 133). Thus, in applying any tax exemption, the general rule is that "tax exemptions are strictly construed in favor of taxation and against the exemption." *Indiana Dep't of State Revenue v. Kimball Int'l Inc.*, 520 N.E.2d 454, 456 (Ind. Ct. App. 1988). The exemptions to which Taxpayer aspires like all tax exemption provisions, is strictly construed against exemption from the tax. *Tri-States Double Cola Bottling Co. v. Dep't of State Revenue*, 706 N.E.2d 282, 283 (Ind. Tax Ct. 1999); *Mynsberge v. Indiana Dep't of State Revenue*, 716 N.E.2d 629, 636 (Ind. Tax Ct. 1999).

IC § 6-2.5-5-3(b), in relevant part, provides:

[T]ransactions involving manufacturing machinery, tools, and equipment are exempt from the state gross retail tax if the person acquiring that property acquires it **for direct use in the direct production, manufacture, fabrication, assembly, extraction, mining, processing, refining, or finishing of other tangible personal property.** (Emphasis added).

IC § 6-2.5-5-5.1(b), in relevant part, provides:

Transactions involving tangible personal property are exempt from the state gross retail tax if the person acquiring the property acquires it **for direct consumption as a material to be consumed in the direct production of other tangible personal property** in the person's business of manufacturing, processing, refining, repairing, mining, agriculture, horticulture, floriculture, or arboriculture. (Emphasis added).

Thus, the Legislature granted Indiana manufacturers a sales tax exemption for certain purchases, which are for "direct use in direct production, manufacture . . . of other tangible personal property." In enacting the exemption, the Legislature clearly did not intend to create a global exemption for any and all equipment which a manufacturer purchases for use within its manufacturing facility. [45 IAC 2.2-5-8\(a\)](#). "[F]airly read, the exemption was meant to apply to capital equipment that meets the 'double direct' test." *Mumma Bros. Drilling Co. v. Indiana Dep't of State Revenue*, 411 N.E.2d 676, 677 (Ind. Ct. App. 1980). The capital equipment "in order to be exempt, (1) must be directly used by the purchaser and (2) be used in the direct production, manufacture, fabrication, assembly, extraction, mining, processing, refining, or finishing of tangible personal property." *Indiana Dep't of State Revenue v. Cave Stone, Inc.*, 457 N.E.2d 520, 525 (Ind. 1983). "[T]he test for directness requires the equipment to have an 'immediate link with the product being produced.'" *Id.* (citing *Department of Revenue v. U. S. Steel Corp.*, 425 N.E.2d 659 (Ind. App. Ct. 1981)).

An exemption applies to "manufacturing machinery, tools, and equipment directly used by the purchaser in direct production." [45 IAC 2.2-5-8\(b\)](#). Manufacturing machinery, tools, and equipment are directly used in the direct production process "if they have an immediate effect on the article being produced." [45 IAC 2.2-5-8\(c\)](#). A machine, tool, or piece of equipment has an immediate effect on the product being produced if it is an essential and integral part of an integrated process that produces the product. *Id.* An integrated process is one where the total production process is comprised of activities or steps that are functionally interrelated and where there is a flow of "work-in-process." [45 IAC 2.2-5-8\(c\)](#), Example (1). "Equipment used to remove raw materials from storage prior to introduction into the production process or to move finished products from the last step of production" is not exempt because the use of the equipment lacks "an essential and integral relationship with the integrated production system." [45 IAC 2.2-5-8\(c\)](#), Example (4)(G).

[45 IAC 2.2-5-8\(k\)](#) describes direct production as the performance of an integrated series of operations which transforms the matter into a form, composition or character different from that in which it was acquired. The change must be substantial resulting in a transformation of the property into a different and distinct product. *Id.*

The exemption for direct consumption in production is further explained at [45 IAC 2.2-5-12](#), in part, as follows:

- (a) The state gross retail tax shall not apply to sales of any tangible personal property consumed in direct production by the purchaser in the business of producing tangible personal property by manufacturing, processing, refining, or mining.
- (b) The exemption provided by this regulation [[45 IAC 2.2](#)] applies only to tangible personal property to be directly consumed in direct production by manufacturing, processing, refining, or mining. It does not apply to machinery, tools, and equipment used in direct production or to materials incorporated into the tangible personal property produced.
- (c) The state gross retail tax does not apply to purchases of materials to be directly consumed in the production process or in mining, provided that such materials are directly used in the production process; **i.e., they have an immediate effect on the article being produced. The property has an immediate effect on the article being produced if it is an essential and integral part of an integrated process which produces tangible personal property.**

(Emphasis added).

[45 IAC 2.2-5-8\(g\)](#) further explains:

"Have an immediate effect upon the article being produced": Machinery, tools, and equipment which are used during the production process and which have an immediate effect upon the article being produced are exempt from tax. Component parts of a unit of machinery or equipment, which unit has an immediate effect on the article being produced, are exempt if such components are an integral part of such manufacturing unit. **The fact that particular property may be considered essential to the conduct of the business of manufacturing because its use is required either by law or by practical necessity does not itself mean that the property "has an immediate effect upon the article being produced". Instead, in addition to being essential for one of the above reasons, the property must also be an integral part of an integrated process which produces tangible personal property. (Emphasis added).**

In this instance, Taxpayer protests the Department's assessment on the Items at Issue, asserting that it was entitled to the exemption pursuant to the Indiana statutes, regulations, and case law. Specifically, Taxpayer refers to [45 IAC 2.2-5-8\(g\)](#), Example (2), which illustrates, "Steam generators used to heat water which is used in mixing and warming component materials in the manufacture of ready-mixed concrete are exempt from tax." To support its protest, Taxpayer submits additional documents, including, but not limited to, "Guide to Cold Weather

Concerting" reported by American Concrete Institute, affidavits, and photos of the Items at Issue.

Upon review, Taxpayer's documentation demonstrates that, specifically, under cold weather condition, it is required to heat the frozen materials, eliminating ice and snow, in order to add the proper amount of water and cement to produce sellable ready-mixed concrete. Thus, the Items at Issue are essential and, when used, have "an immediate effect upon the article being produced." Additionally, Taxpayer's documentation demonstrates that its ready-mix concrete is produced following a specific formula consisting of sand, aggregates, water, and cement. The Items at Issue, when used, are used in a continuous and needed basis daily under the cold weather condition standards and are an integral part of the cold weather concrete manufacturing production. Taxpayer's documentation further demonstrates that the Items at Issue are not used for the purposes of preparing and storing/stockpiling the raw materials. Thus, the Department is prepared to agree with Taxpayer that it has met its burden of proof that the purchase and use of the Items at Issue are exempt.

In short, given the totality of the circumstances, Taxpayer's documentation demonstrates that the Items at Issue, when used, are essential to and an integral part of its manufacturing process in producing ready-mix concrete under cold weather conditions and thus are exempt.

FINDING

Taxpayer's protest is sustained. The Department will remove the assessment of the Items at Issue and recalculate Taxpayer's liability in a supplemental audit.

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